

Introduced by Senator Campbell

February 15, 2005

An act to amend Sections 17276, 23802, 23803, and 23806 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 259, as introduced, Campbell. Corporation tax: "S" corporation.

The Corporation Tax Law provides that, for taxable years beginning on or after January 1, 2002, corporations that have elected to be taxed as "S" corporations for federal tax purposes are deemed to be "S" corporations for California income tax purposes, unless the entity is prohibited from being a California "S" corporation. The Corporation Tax Law, in modified conformity to federal income tax laws, provides for the specified tax treatment of "S" corporations and their shareholders. Among other things, that law requires that an election made under federal income tax laws, relating to certain stock purchases treated as asset acquisitions, be treated as an election for state tax purposes, specifies the application of credits to reduce the entity level tax, and imposes a tax on built-in gains attributable to California sources, as provided.

This bill, for taxable years beginning on or after January 1, 2004, would allow an "S" corporation, as provided, to carry forward a net operating loss incurred by that corporation as a "C" corporation from its last taxable year beginning before January 1, 2002, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an "S" corporation for state tax purposes as a result of the enactment of Chapter 35 of the Statutes of 2002. This bill would also allow an "S" corporation to carry forward the full amount

of tax credits, as specified, generated by that corporation as a “C” corporation to the first taxable year beginning on or after January 1, 2003, in which the corporation is deemed to be an “S” corporation for state tax purposes pursuant to Chapter 35 of the Statutes of 2002.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 17276 of the Revenue and Taxation
2 Code is amended to read:
3 17276. Except as provided in Sections 17276.1, 17276.2,
4 17276.4, 17276.5, 17276.6, and 17276.7, the deduction provided
5 by Section 172 of the Internal Revenue Code, relating to a net
6 operating loss deduction, shall be modified as follows:
7 (a) (1) Net operating losses attributable to taxable years
8 beginning before January 1, 1987, ~~shall not be~~ *is not* allowed.
9 (2) A net operating loss shall not be carried forward to any
10 taxable year beginning before January 1, 1987.
11 (b) (1) Except as provided in paragraphs (2) and (3), *and*
12 *paragraph (4) of subdivision (d) of Section 23802*, the provisions
13 of Section 172(b)(2) of the Internal Revenue Code, relating to the
14 amount of carryovers, shall be modified so that the applicable
15 percentage of the entire amount of the net operating loss for any
16 taxable year shall be eligible for carryover to any subsequent
17 taxable year. For purposes of this subdivision, the applicable
18 percentage shall be:
19 (A) Fifty percent for any taxable year beginning before
20 January 1, 2000.
21 (B) Fifty-five percent for any taxable year beginning on or
22 after January 1, 2000, and before January 1, 2002.
23 (C) Sixty percent for any taxable year beginning on or after
24 January 1, 2002, and before January 1, 2004.
25 (D) One hundred percent for any taxable year beginning on or
26 after January 1, 2004.
27 (2) In the case of a taxpayer who has a net operating loss in
28 any taxable year beginning on or after January 1, 1994, and who
29 operates a new business during that taxable year, each of the

1 following shall apply to each loss incurred during the first three
2 taxable years of operating the new business:

3 (A) If the net operating loss is equal to or less than the net loss
4 from the new business, 100 percent of the net operating loss shall
5 be carried forward as provided in subdivision (d).

6 (B) If the net operating loss is greater than the net loss from
7 the new business, the net operating loss shall be carried over as
8 follows:

9 (i) With respect to an amount equal to the net loss from the
10 new business, 100 percent of that amount shall be carried
11 forward as provided in subdivision (d).

12 (ii) With respect to the portion of the net operating loss that
13 exceeds the net loss from the new business, the applicable
14 percentage of that amount shall be carried forward as provided in
15 subdivision (d).

16 (C) For purposes of Section 172(b)(2) of the Internal Revenue
17 Code, the amount described in clause (ii) of subparagraph (B)
18 shall be absorbed before the amount described in clause (i) of
19 subparagraph (B).

20 (3) In the case of a taxpayer who has a net operating loss in
21 any taxable year beginning on or after January 1, 1994, and who
22 operates an eligible small business during that taxable year, each
23 of the following shall apply:

24 (A) If the net operating loss is equal to or less than the net loss
25 from the eligible small business, 100 percent of the net operating
26 loss shall be carried forward to the taxable years specified in
27 subdivision (d).

28 (B) If the net operating loss is greater than the net loss from
29 the eligible small business, the net operating loss shall be carried
30 over as follows:

31 (i) With respect to an amount equal to the net loss from the
32 eligible small business, 100 percent of that amount shall be
33 carried forward as provided in subdivision (d).

34 (ii) With respect to that portion of the net operating loss that
35 exceeds the net loss from the eligible small business, the
36 applicable percentage of that amount shall be carried forward as
37 provided in subdivision (d).

38 (C) For purposes of Section 172(b)(2) of the Internal Revenue
39 Code, the amount described in clause (ii) of subparagraph (B)

1 shall be absorbed before the amount described in clause (i) of
2 subparagraph (B).

3 (4) In the case of a taxpayer who has a net operating loss in a
4 taxable year beginning on or after January 1, 1994, and who
5 operates a business that qualifies as both a new business and an
6 eligible small business under this section, that business shall be
7 treated as a new business for the first three taxable years of the
8 new business.

9 (5) In the case of a taxpayer who has a net operating loss in a
10 taxable year beginning on or after January 1, 1994, and who
11 operates more than one business, and more than one of those
12 businesses qualifies as either a new business or an eligible small
13 business under this section, paragraph (2) shall be applied first,
14 except that if there is any remaining portion of the net operating
15 loss after application of clause (i) of subparagraph (B) of that
16 paragraph, paragraph (3) shall be applied to the remaining
17 portion of the net operating loss as though that remaining portion
18 of the net operating loss constituted the entire net operating loss.

19 (6) For purposes of this section, the term “net loss” means the
20 amount of net loss after application of Sections 465 and 469 of
21 the Internal Revenue Code.

22 (c) Net operating loss carrybacks ~~shall not be~~ *is not* allowed.

23 (d) (1) (A) For a net operating loss for any taxable year
24 beginning on or after January 1, 1987, and before January 1,
25 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code,
26 relating to years to which net operating losses may be carried, is
27 modified to substitute “five taxable years” in lieu of “20 taxable
28 years” except as otherwise provided in paragraphs (2) and (3).

29 (B) For a net operating loss for any taxable year beginning on
30 or after January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal
31 Revenue Code, relating to years to which net operating losses
32 may be carried, is modified to substitute “10 taxable years” in
33 lieu of “20 taxable years.”

34 (2) For any taxable year beginning before January 1, 2000, in
35 the case of a “new business,” the “five taxable years” in
36 paragraph (1) shall be modified to read as follows:

37 (A) “Eight taxable years” for a net operating loss attributable
38 to the first taxable year of that new business.

39 (B) “Seven taxable years” for a net operating loss attributable
40 to the second taxable year of that new business.

1 (C) "Six taxable years" for a net operating loss attributable to
2 the third taxable year of that new business.

3 (3) For any carryover of a net operating loss for which a
4 deduction is denied by Section 17276.3, the carryover period
5 specified in this subdivision shall be extended as follows:

6 (A) By one year for a net operating loss attributable to taxable
7 years beginning in 1991.

8 (B) By two years for a net operating loss attributable to
9 taxable years beginning prior to January 1, 1991.

10 (4) The net operating loss attributable to taxable years
11 beginning on or after January 1, 1987, and before January 1,
12 1994, shall be a net operating loss carryover to each of the 10
13 taxable years following the year of the loss if it is incurred by a
14 taxpayer that is under the jurisdiction of the court in a Title 11 or
15 similar case at any time during the income year. The loss
16 carryover provided in the preceding sentence shall not apply to
17 any loss incurred after the date the taxpayer is no longer under
18 the jurisdiction of the court in a Title 11 or similar case.

19 (e) For purposes of this section:

20 (1) "Eligible small business" means any trade or business that
21 has gross receipts, less returns and allowances, of less than one
22 million dollars (\$1,000,000) during the taxable year.

23 (2) Except as provided in subdivision (f), "new business"
24 means any trade or business activity that is first commenced in
25 this state on or after January 1, 1994.

26 (3) "Title 11 or similar case" shall have the same meaning as
27 in Section 368(a)(3) of the Internal Revenue Code.

28 (4) In the case of any trade or business activity conducted by a
29 partnership or ~~"S corporation,"~~ *"S" corporation*, paragraphs (1)
30 and (2) shall be applied to the partnership or ~~"S corporation."~~
31 *"S" corporation*.

32 (f) For purposes of this section, in determining whether a trade
33 or business activity qualifies as a new business under paragraph
34 (2) of subdivision (e), the following rules shall apply:

35 (1) In any case where a taxpayer purchases or otherwise
36 acquires all or any portion of the assets of an existing trade or
37 business (irrespective of the form of entity) that is doing business
38 in this state (within the meaning of Section 23101), the trade or
39 business thereafter conducted by the taxpayer (or any related
40 person) shall not be treated as a new business if the aggregate fair

1 market value of the acquired assets (including real, personal,
2 tangible, and intangible property) used by the taxpayer (or any
3 related person) in the conduct of its trade or business exceeds 20
4 percent of the aggregate fair market value of the total assets of
5 the trade or business being conducted by the taxpayer (or any
6 related person). For purposes of this paragraph only, the
7 following rules shall apply:

8 (A) The determination of the relative fair market values of the
9 acquired assets and the total assets shall be made as of the last
10 day of the first taxable year in which the taxpayer (or any related
11 person) first uses any of the acquired trade or business assets in
12 its business activity.

13 (B) Any acquired assets that constituted property described in
14 Section 1221(1) of the Internal Revenue Code in the hands of the
15 transferor shall not be treated as assets acquired from an existing
16 trade or business, unless those assets also constitute property
17 described in Section 1221(1) of the Internal Revenue Code in the
18 hands of the acquiring taxpayer (or related person).

19 (2) In any case where a taxpayer (or any related person) is
20 engaged in one or more trade or business activities in this state,
21 or has been engaged in one or more trade or business activities in
22 this state within the preceding 36 months (“prior trade or
23 business activity”), and thereafter commences an additional trade
24 or business activity in this state, the additional trade or business
25 activity shall only be treated as a new business if the additional
26 trade or business activity is classified under a different division
27 of the Standard Industrial Classification (SIC) Manual published
28 by the United States Office of Management and Budget, 1987
29 edition, than are any of the taxpayer’s (or any related person’s)
30 current or prior trade or business activities.

31 (3) In any case where a taxpayer, including all related persons,
32 is engaged in trade or business activities wholly outside of this
33 state and the taxpayer first commences doing business in this
34 state (within the meaning of Section 23101) after December 31,
35 1993 (other than by purchase or other acquisition described in
36 paragraph (1)), the trade or business activity shall be treated as a
37 new business under paragraph (2) of subdivision (e).

38 (4) In any case where the legal form under which a trade or
39 business activity is being conducted is changed, the change in
40 form shall be disregarded and the determination of whether the

1 trade or business activity is a new business shall be made by
2 treating the taxpayer as having purchased or otherwise acquired
3 all or any portion of the assets of an existing trade or business
4 under the rules of paragraph (1) of this subdivision.

5 (5) “Related person” shall mean any person that is related to
6 the taxpayer under either Section 267 or 318 of the Internal
7 Revenue Code.

8 (6) “Acquire” shall include any gift, inheritance, transfer
9 incident to divorce, or any other transfer, whether or not for
10 consideration.

11 (7) (A) For taxable years beginning on or after January 1,
12 1997, the term “new business” shall include any taxpayer that is
13 engaged in biopharmaceutical activities or other biotechnology
14 activities that are described in Codes 2833 to 2836, inclusive, of
15 the Standard Industrial Classification (SIC) Manual published by
16 the United States Office of Management and Budget, 1987
17 edition, and as further amended, and that has not received
18 regulatory approval for any product from the United States Food
19 and Drug Administration.

20 (B) For purposes of this paragraph:

21 (i) “Biopharmaceutical activities” means those activities that
22 use organisms or materials derived from organisms, and their
23 cellular, subcellular, or molecular components, in order to
24 provide pharmaceutical products for human or animal
25 therapeutics and diagnostics. Biopharmaceutical activities make
26 use of living organisms to make commercial products, as
27 opposed to pharmaceutical activities that make use of chemical
28 compounds to produce commercial products.

29 (ii) “Other biotechnology activities” means activities
30 consisting of the application of recombinant DNA technology to
31 produce commercial products, as well as activities regarding
32 pharmaceutical delivery systems designed to provide a measure
33 of control over the rate, duration, and site of pharmaceutical
34 delivery.

35 (g) In computing the modifications under Section 172(d)(2) of
36 the Internal Revenue Code, relating to capital gains and losses of
37 taxpayers other than corporations, the exclusion provided by
38 Section 18152.5 shall not be allowed.

39 (h) Notwithstanding any provisions of this section to the
40 contrary, a deduction shall be allowed to a “qualified taxpayer”

1 as provided in Sections 17276.1, 17276.2, 17276.4, 17276.5,
2 17276.6, and 17276.7.

3 (i) The Franchise Tax Board may prescribe appropriate
4 regulations to carry out the purposes of this section, including
5 any regulations necessary to prevent the avoidance of the
6 purposes of this section through splitups, shell corporations,
7 partnerships, tiered ownership structures, or otherwise.

8 (j) The Franchise Tax Board may reclassify any net operating
9 loss carryover determined under either paragraph (2) or (3) of
10 subdivision (b) as a net operating loss carryover under paragraph
11 (1) of subdivision (b) upon a showing that the reclassification is
12 necessary to prevent evasion of the purposes of this section.

13 (k) Except as otherwise provided, the amendments made by
14 Chapter 107 of the Statutes of 2000 shall apply to net operating
15 losses for taxable years beginning on or after January 1, 2000.

16 *(l) The amendments made by the act adding this subdivision*
17 *shall apply to taxable years beginning on or after January 1,*
18 *2004.*

19 SEC. 2. Section 23802 of the Revenue and Taxation Code is
20 amended to read:

21 23802. (a) Section 1363(a) of the Internal Revenue Code,
22 relating to the taxability of an “S” corporation does not apply.

23 (b) Corporations that are “S” corporations under this chapter
24 shall continue to be subject to the taxes imposed under Chapter 2
25 (commencing with Section 23101) and Chapter 3 (commencing
26 with Section 23501), except as follows:

27 (1) The tax imposed under Section 23151 or 23501 shall be
28 imposed at a rate of 1 ½ percent rather than the rate specified in
29 those sections.

30 (2) In the case of an “S” corporation that is also a financial
31 corporation, the rate of tax specified in paragraph (1) shall be
32 increased by the excess of the rate imposed under Section 23183
33 over the rate imposed under Section 23151.

34 (c) An “S” corporation shall be subject to the minimum
35 franchise tax imposed under Section 23153.

36 (d) (1) For purposes of subdivision (b), an “S” corporation
37 shall be allowed a deduction under Section 24416 or 24416.1
38 (relating to net operating loss deductions), but only with respect
39 to losses incurred during periods in which the corporation is an
40 “S” corporation for purposes of this part.

(2) Section 1371(b) of the Internal Revenue Code, relating to denial of carryovers between “C” years and “S” years, shall apply for purposes of the tax imposed under subdivision (b), except as provided in paragraph (1).

(3) The provisions of this subdivision, *other than paragraph (5) for purposes of the “S” corporation’s taxable year beginning on or after January 1, 2004*, do not affect the amount of any item of income or loss computed in accordance with the provisions of Section 1366 of the Internal Revenue Code, relating to pass-thru of items to shareholders.

(4) For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an “S” corporation, to the extent otherwise allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss, *except with respect to losses resulting from the provisions of paragraph (5) to the extent it would result in a duplication of the limitations provided in Section 24416*.

(5) (A) *A corporation, described in paragraph (1), is also allowed to carry forward a net operating loss incurred by the corporation as a “C” corporation, as allowed under this part, from the last taxable year beginning before January 1, 2002, in which that corporation was treated as a “C” corporation, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an “S” corporation pursuant to the enactment of Chapter 35 of the Statutes of 2002, and to the subsequent taxable years as allowed under paragraph (1) of this subdivision.*

(B) *This paragraph applies to a corporation that, for its last taxable year beginning before January 1, 2002, was an “S” corporation for federal income tax purposes and a “C” corporation for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, and, as a result of the enactment of Chapter 35 of the Statutes of 2002, is an “S” corporation for the corporation’s taxable years beginning on or after January 1, 2004.*

(e) For purposes of computing the taxes specified in subdivision (b), ~~an “S”~~ an “S” corporation shall be allowed a deduction from income for built-in gains and passive investment

1 income for which a tax has been imposed under this part in
2 accordance with the provisions of Section 1374 of the Internal
3 Revenue Code, relating to tax imposed on certain built-in gains,
4 or Section 1375 of the Internal Revenue Code, relating to tax
5 imposed on passive investment income.

6 (f) For purposes of computing taxes imposed under this part,
7 as provided in subdivision (b):

8 (1) An “S” corporation shall compute its deductions for
9 amortization and depreciation in accordance with the provisions
10 of Part 10 (commencing with Section 17001) of Division 2.

11 (2) Section 465 of the Internal Revenue Code, relating to
12 limitation of deductions to the amount at risk, shall be applied in
13 the same manner as in the case of an individual.

14 (3) (A) Section 469 of the Internal Revenue Code, relating to
15 limitations on passive activity losses and credits, shall be applied
16 in the same manner as in the case of an individual. For purposes
17 of the tax imposed under Section 23151 or 23501, as modified by
18 this section, material participation shall be determined in
19 accordance with Section 469(h) of the Internal Revenue Code,
20 relating to certain closely held “C” corporations and personal
21 service corporations.

22 (B) For purposes of this paragraph, the “adjusted gross
23 income” of the “S” the “S” corporation shall be equal to its “net
24 income,” as determined under Section 24341 with the
25 modifications required by this subdivision, except that no
26 deduction shall be allowed for contributions allowed by Section
27 24357.

28 (4) The exclusion provided under Section 18152.5 may not be
29 allowed to an “S” corporation.

30 (5) The deduction for bad debts under paragraph (2) of
31 subdivision (a) of Section 24348 may not be allowed to an “S”
32 corporation.

33 (g) (1) The provisions of Section 1363(d) of the Internal
34 Revenue Code, relating to recapture of LIFO benefits, shall be
35 modified for purposes of this part to refer to Section 19101 in
36 lieu of Section 6601 of the Internal Revenue Code.

37 (2) For purposes of Section 19023, relating to the definition of
38 “estimated tax,” and Section 19142, relating to an addition to tax
39 for underpayment of estimated tax, the tax imposed pursuant to
40 this subdivision is not a tax imposed by this part.

(h) The amendments made by the act adding this subdivision shall apply to taxable years ending on or after December 31, 2001.

SEC. 3. Section 23803 of the Revenue and Taxation Code is amended to read:

23803. (a) With respect to credits that are otherwise allowed to reduce the taxes imposed under this part:

(1) The amount of any credit to be claimed shall be limited to one-third of the amount otherwise allowable.

(2) (A) Any unused portion of the credit allowable under paragraph (1) (one-third of the total credit) shall be allowed to be carried forward and may not be subject to additional reductions under paragraph (1) in later years.

(B) No carryforward shall be allowed for the portion of the credit denied under paragraph (1) (two-thirds of the total credit).

(C) Credits carried forward from taxable years beginning prior to the first taxable year in which the corporation is treated as an "S corporation" under this part, shall be reduced in accordance with paragraph (1) for that first taxable year and may not be subject to additional reductions under paragraph (1) in later years.

~~(D) The provisions of paragraphs~~

(D) (i) (I) Notwithstanding any other provision of law, paragraph (1) of this subdivision does not apply to credits generated by a corporation that is described in clause (ii) and carried forward from the last taxable year beginning before January 1, 2002, in which that corporation was treated as a "C" corporation, to the first taxable year beginning on or after January 1, 2003, in which the corporation is treated as an "S" corporation pursuant to the enactment of Chapter 35 of the Statutes of 2002. The credits that are carried forward from the last taxable year of the "C" corporation beginning before January 1, 2002, may not be reduced in later years and may be utilized to offset the tax imposed under either Section 23151 or Section 23501.

(II) For purposes of this section, for taxable years beginning on or after January 1, 2003, the amount of credit available to a corporation, which is described in clause (ii), is the amount of credit carried forward from the corporation's last taxable year beginning before January 1, 2002, in which the corporation was

1 *treated as a “C” corporation, and calculated without the*
2 *limitations imposed by paragraph (1), less the amount of credit*
3 *utilized by the corporation for its taxable year beginning on or*
4 *after January 1, 2002, and increased by any amount of credit*
5 *otherwise allowed by this section (and not utilized) for the*
6 *corporation for its taxable year beginning on or after January 1,*
7 *2002.*

8 *(ii) This subparagraph applies to a corporation that, for its*
9 *last taxable year beginning before January 1, 2002, was an “S”*
10 *corporation for federal income tax purposes and a “C”*
11 *corporation for purposes of Part 10 (commencing with Section*
12 *17001), Part 10.2 (commencing with Section 18401), and this*
13 *part, and, as a result of the enactment of Chapter 35 of the*
14 *Statutes of 2002, is an “S” corporation for the corporation’s*
15 *taxable year beginning on or after January 1, 2003.*

16 *(E) Paragraphs (2) and (3) of subdivision (f) of Section 23802*
17 *shall be applied prior to the reduction required by paragraph (1).*

18 ~~*(E)*~~

19 *(F) No portion of any credit to which this subdivision applies*
20 *shall be passed through to the shareholders of the “S*
21 *corporation.” “S” corporation.*

22 ~~*(F)*~~

23 *(G) The provisions of this subdivision do not affect the*
24 *amount of any credit computed under Part 10 (commencing with*
25 *Section 17001) for ~~pass-through~~ *pass-through* to shareholders in*
26 *accordance with the provisions of Section 1366 of the Internal*
27 *Revenue Code.*

28 *(b) Section 1366(f) of the Internal Revenue Code, relating to*
29 *special rules, shall be modified as follows:*

30 *(1) The amount of tax used to compute the loss allowed by*
31 *Section 1366(f)(2) ~~shall be~~ *is* the amount of tax imposed on*
32 *built-in gains under this part.*

33 *(2) The amount of tax used to compute the reduction allowed*
34 *by Section 1366(f)(3) ~~shall be~~ *is* the amount of tax imposed on*
35 *excess net passive income under this part.*

36 *(c) The amendments to this section made by this act shall*
37 *apply to taxable years beginning on or after January 1, 2003.*

38 SEC. 4. Section 23806 of the Revenue and Taxation Code is
39 amended to read:

23806. (a) Section 1371(a) of the Internal Revenue Code, relating to application of Subchapter C rules, is modified to provide that, notwithstanding subdivisions (a) and (e) of Sections 17024.5 and 23051.5, any election by an ~~“S corporation”~~ “S” corporation or its shareholders under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, for federal purposes shall be treated as an election for purposes of this part and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 or 23051.5 ~~shall not be~~ *is not allowed*.

(b) No election under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, ~~shall be~~ *is allowed* for state tax purposes unless the ~~“S corporation”~~ “S” corporation or its shareholders made a valid election for federal purposes under Section 338 of the Internal Revenue Code.

(c) Section 1371 (d) of the Internal Revenue Code ~~shall~~ *does not apply*.

(d) (1) Subdivisions (a) and (b) ~~shall~~ apply to any transaction occurring on or after January 1, 1998, in a taxable year beginning on or after January 1, 1997.

(2) Subdivision (c) ~~shall apply~~ *applies* to taxable years beginning on or after January 1, 1997.

(e) (1) *A corporation described in paragraph (2) is also allowed to carry forward a net operating loss incurred by the corporation as a “C” corporation, as allowed under this part, from the last taxable year beginning before January 1, 2002, in which that corporation was treated as a “C” corporation, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an “S” corporation pursuant to the enactment of Chapter 35 of the Statutes of 2002 and to the subsequent taxable years, if allowed.*

(2) *This subdivision applies to a corporation that, for its last taxable year beginning before January 1, 2002, was an “S” corporation for federal income tax purposes and a “C” corporation for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, and, as a result of the enactment of Chapter 35 of the Statutes of 2002, is an “S” corporation for the corporation’s taxable years beginning on or after January 1, 2004.*

1 (f) *The amendments made by the act adding this subdivision*
2 *shall apply to taxable years beginning on or after January 1,*
3 *2004.*

4 SEC. 5. The Legislature finds and declares that the
5 application of this act to taxable years beginning on and after
6 January 1, 2002, serves a public purpose by ensuring the fair and
7 consistent application of California tax law, by avoiding possible
8 legal challenges to that law or its application, and by allowing
9 taxpayers to retain certain tax benefits to which they were legally
10 entitled and to utilize the tax credits earned by the taxpayers
11 while operating under existing state tax laws.

12 SEC. 6. This act provides for a tax levy within the meaning of
13 Article IV of the Constitution and shall go into immediate effect.